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SUBJECT: KOSOVO SEEKS TO MAINTAIN MOMENTUM IN DEVELOPING
LIGNITE MINES AND ENERGY SECTOR TENDER

REF: 06 KOSOVO 545

SENSITIVE BUT UNCLASSIFIED - PLEASE PROTECT ACCORDINGLY

¶1. (SBU) Summary. The Kosovo/World Bank energy sector development project, known as the Lignite Power Technical Assistance Project (LPTAP), has made some progress, but ensuring coordination between UNMIK/PISG and the international community on the way to move forward remains a challenge. The PISG has proposed the creation of a new lignite mining company to be spun off from KEK's mining department. According to the PISG, this would expedite the development of new mines, obtain money to rehabilitate excavators to remove overburden, and keep the energy sector development tender moving forward. The creation of a new lignite mining company is part of the options analysis conducted by EAR for the energy sector's development. However, the World Bank is hesitant for this project to move forward without its transaction advisor, who should be in place by April. In addition, the IMF, and some officials in UNMIK Pillar IV, UNMIK's Office for Oversight of Publicly-Owned Enterprises and the Kosovo Trust Agency (KTA), have expressed concerns about how UNMIK and the PISG plan to take money from PTK to fund the rehabilitation of the excavators, as well as the possible short and medium term impacts on KEK. USOP will take the lead to encourage UNMIK/PISG and the international community to sit down at the same table to improve their coordination to ensure that we all do what is in the best interests for Kosovo's energy sector and economic development in general. End Summary.

LPTAP PROJECT ACHIEVES SOME SUCCESSES...

¶2. (U) Since UNMIK/PISG and the World Bank reached an agreement on the Lignite Power Technical Assistance Project (LPTAP) in mid-June 2006 (reftel), the Ministry of Energy and Mining (MEM) and the LPTAP Project Steering Committee (PSC) have kept the energy sector development tender moving forward. In August, the PSC launched a World Bank-approved expression of interest (EOI) request for companies to submit their pre-qualification criteria for the upcoming energy sector development tender. In October 2006, MEM hosted a successful investors conference to discuss Kosovo's energy sector development strategy and the tender. In November, ten companies submitted their EOIs for the energy sector development tender, with quantity and quality of interested bidders better than anticipated by the PSC. On December 28,

2006, Energy and Mining Minister Ethem Ceku informed USOP that the PSC selected four companies to be shortlisted to compete for the energy sector tender. The four companies/consortia are EnBW/Washington Group (German/USA), Enel/PPC/Contour Global (Italy/Greece/USA), CEZ/AES (Czech/USA), and Germany company RWE Power AG.

...BUT CHALLENGES REMAIN

¶3. (SBU) The primary challenge confronting the LPTAP is to ensure coordination between UNMIK/PISG and the international community. UNMIK/MEM and some members of the international community are concerned that the World Bank's timeline has slipped by six months to April 2007 to have a transaction advisor, legal advisor and environmental advisor in Kosovo to prepare for and launch the energy sector development tender. World Bank officials blame the delay on the Kosovars, saying that the PSC/MEM are behind schedule in appointing a project manager for the LPTAP, the Bank has not received revised draft request for proposals (RFPs) from PSC/MEM for the legal and safeguard advisors, and the Bank wants assurances from the Kosovo Trust Agency (KTA), which is responsible for the administration and maintenance of socially-owned enterprises (SOEs) and publicly-owned enterprises (POEs), that no other lignite mining licenses will be issued that could adversely affect this project. For its part, MEM attributes some of the reasons for delay to World Bank inefficiencies in approving certain PSC actions, as well as the Bank insisting on substantial non-material changes in documentation. In addition, there is serious concern from UNMIK/PISG and the international community that the LPTAP process is not prepared to address the short and medium-term problems of the rapid depletion of existing lignite mines to power KEK's plants, which are scheduled to run out of coal by 2009-2010.

MEM PROPOSES A WAY FORWARD FOR LIGNITE COAL DEVELOPMENT WITH UNMIK SUPPORT

¶4. (SBU) In November 2006, the PISG approved the MEM's proposal to unbundle KEK's mining department to form a new joint stock company called the Kosovo Lignite Mining Company. MEM officials said forming this new company was necessary to obtain loans from banks to rehabilitate two excavators to remove overburden. MEM officials added that creating the new lignite mining company is part of the European Agency for Reconstruction-funded options analysis to explore ways to develop Kosovo's energy sector, which also supports the LPTAP. UNMIK, under the guidance of PDSRSG Steven Schook, supports MEM's proposal because it is concerned about the existing lignite coal resources and believes that the MEM's plan helps the LPTAP project move forward while waiting for the World Bank's transaction advisor to arrive in Kosovo. UNMIK officials maintain that UNSCR 1244 allows UNMIK via the KTA to form the Kosovo Lignite Mining Company, and they propose to take 40-65 million euros from telecommunications monopoly Post and Telecom of Kosovo (PTK) to pay for the rehabilitation of the excavators.

WORLD BANK OFFICIALS HESITANT ABOUT SUPPORTING NEW LIGNITE MINING COMPANY WITHOUT ITS TRANSACTION ADVISOR

¶5. (SBU) World Bank officials have reservations about this plan, noting that the decision to form a new company was made without the Bank's recommendation from its transaction and legal advisors. World Bank officials believe that UNMIK and PISG officials formally agreed in the Bank's Letter of Sector Development Policy (LSDP) and LPTAP that its transaction and legal advisors would make any recommendations to restructure Kosovo's lignite-related activities. World Bank officials claim they were not invited to participate in the UNMIK/PISG meetings with other donors to discuss how to move the Kosovo Lignite Mining Company forward. However, in December 2006, World Bank officials agreed that UNMIK/PISG could take preliminary steps to prepare the necessary legal framework and paperwork in advance of the arrival of the transaction advisor, such as forming the mining company as a publicly-owned enterprise and purchasing parts to

rehabilitate the excavators.

IMF VOICES CONCERNS ABOUT THE NEW LIGNITE MINING COMPANY AND FUNDING THE EXCAVATORS

¶ 6. (SBU) On December 20, 2006, the International Monetary Fund's (IMF) Resident Representative to Kosovo, Edgardo Ruggiero, expressed his concerns about UNMIK/PISG plans to develop the new lignite mining company and fund the rehabilitation of the excavators from PTK revenues. He said the IMF is concerned that this plan is being rushed by UNMIK and PISG, and in particular complained about the funding proposal for the new lignite mining company and the rehabilitation of the excavators. Ruggiero explained that UNMIK and PISG have not revised the Medium Term Expenditure Framework (MTEF) to take into account these ideas and their short- and long-term impacts on the Kosovo Consolidated Budget (KCB). He noted that the MTEF already has a proposal to fund the development of new mines, but if this plan had to be revised it should be done according to the appropriate budgetary and macroeconomic policy procedures.

¶ 7. (SBU) Ruggiero was particularly critical of UNMIK/PISG's proposal to take money from PTK to fund the rehabilitation of the excavators, noting that this was not good budgetary practice to address important needs, and that Kosovo should avoid setting bad precedents to deal with emergencies. He added that UNMIK and PISG should also give careful consideration to KEK's operational sustainability because Kosovo will need the energy utility for the short and medium term. Ruggiero said the IMF understood the immediate needs of the mining situation, but budgetary and procurement practices should be respected.

PILLAR IV, KTA AND UNMIK POE OVERSIGHT OFFICE ALSO VOICE CONCERN ABOUT THE PROCESS FOR THE NEW LIGNITE MINING COMPANY

¶ 8. (SBU) There are also some officials in UNMIK Pillar IV, which is responsible for Kosovo economic policy, KTA, and UNMIK's Office of Oversight of Publicly-Owned Enterprises (OPOEs) who have expressed concerns about the development of this new lignite mining company. Pillar IV, KTA and OPOE officials share the IMF's concerns that the lignite mining company is moving too fast without proper analysis of its impact on PTK, KEK and Kosovo's budgetary policies and procedures. OPOE officials say they are concerned about UNMIK setting bad budgetary, economic and legal precedents that the PISG could follow if the Kosovo Lignite Mining Company is not analyzed and vetted properly.

URGENT NEED TO GET ALL STAKEHOLDERS AT THE SAME TABLE TO DISCUSS THE ENERGY SECTOR

¶ 9. (SBU) Comment: We recognize the urgent necessity to develop new mines for the existing KEK plants and the new energy sector development tender, as the current lignite sources will run out by 2009-2010. UNMIK and MEM should be given some credit for taking bold action to address this issue. However, it is important to bring all stakeholders together to improve communication and coordination. USOP believes that an important step in developing the mines is to ensure that UNMIK, PISG and the international community are clearly in sync with each other; the World Bank should be pressed to live up to its commitments and understand the urgency of Kosovo's energy needs, while the Kosovars and UNMIK should make every effort to keep the World Bank on board with their plans. There is real urgency in moving this project forward, since the long-term stability and economic development in Kosovo are dependent on the resolution of the energy problems here. End Comment.

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